R. v. DIRECTOR-GENERAL OF INLAND REVENUE

[A.C.J. (Gill C.J. (Malaya)) January 18, 1975]
[Kuala Lumpur — Originating Motion No. 73 of 1972]

Income Tax — Termination of service — Payment of compensation — Whether compensation for loss of employment or gratuity in respect of having or exercising employment — Income Tax Act, 1967, s. 13(1)(a) & (e) and Sch. 6, para. 15(1)(b).

The appellant was originally appointed as a traffic superintendent by a company engaged in the business of iron ore production for a period of three years and thereafter he was employed for further continuous periods by a series of agreements for fixed periods ranging from 21 months to 3 years. In the last agreement however nothing was stated as to the duration of the agreement. Each of the agreements provided for termination of his services at any time by giving 3 months notice in writing on either side. When it became apparent that the end of the mines was approaching, the company as an inducement to those senior officers whom they wished to retain gave an assurance that if the services of a non-Malaysian officer were no longer required, the officer would be paid a lump sum equal to one year's salary by way of compensation for loss of expectation of further employment. The appellant's services were terminated under the provisions of his last service agreement and he was paid a lump sum of $35,400/-. He was then 48 years old and had worked for the company for 19 years. The appellant was assessed for tax on the sum of $35,400/- and on appeal the Special Commissioners held that the sum was paid to the appellant in respect of services rendered and was a remuneration or gratuity within the meaning of section 13(1)(a) of the Income Tax Act, 1967. The appellant appealed by way of case stated.

Held, allowing the appeal: the sum of $35,400/- paid to the appellant by his employers was compensation for loss of employment and as such was not liable to income tax by reason of the exemption under paragraph 15(1)(a) of Schedule 6 to the Income Tax Act.

Cases referred to:-

(1) *Chibbett* v. *Joseph Robinson & Sons* (1924) 9 T.C. 48.
(2) *Hunter* v. *Dewhurst* (1932) 16 T.C. 615, 637.
(3) *Henry* v. *Foster* (1931) 16 T.C. 605, 629.
(4) *Holloway* v. *Poplar Corporation* [1940] 1 K.B. 173, 178.
(5) *Prichard* v. *Arundale* [1971] 3 W.L.R. 877.
(6) *Cameron* v. *Prendergast* [1940] 2 All E.R. 35.
(7) *Comptroller-General of Inland Revenue* v. *T. (Knight's case)* [1972] 2 M.L.J. 73.
(8) *H.* v. *Comptroller-General of Inland Revenue (Heywood's case)* (1973) 2 M.L.J. 40.
(9) *H.* v. *Comptroller of Inland Revenue* [1974] 2 M.L.J. 135.

CASE STATED.

S. Woodhull for the appellant.

Mohamed Nizar bin Idris (Senior Federal Counsel) for the respondent.

Gill C.J.: This is an appeal by way of case stated from a deciding order of the Special Commissioners of Income Tax. The question at issue in the appeal is whether the sum of $35,400/- paid to the appellant by his employers, the Eastern Mining & Metals Co. Ltd. (hereinafter referred to as EMMCO), on the termination of his services, is liable to income tax under the provisions of the Income Tax Act, 1967.

EMMCO was incorporated on 5th August 1948 with the main object of carrying on the business of iron ore production. Subsequently, it became the parent company of a group of associated companies. The group's two main areas of production were Bukit Besi of EMMCO in Trengganu and Bukit Ibam of Rompin Mining Co. in Pahang. The group had a large labour force in their employment comprising some 5,000 to 6,000 skilled and unskilled personnel. The senior technical and administrative officers, however, formed a very small fraction of the total number of employees and most of them were non-Malaysian expatriates.

The appellant was one of their senior non-Malaysian expatriate employees. He was first appointed by EMMCO as their traffic superintendent for a period of 3 years from 7th February 1952. Thereafter he was employed for further continuous periods by a series of agreements, the first seven of which provided for fixed periods of employment ranging from 21 months to 3 years. In the eighth and last agreement dated 24th September 1969, however, nothing was stated as to the duration of the agreement. Each of the agreements provided for termination of his services at any time by 3 months' notice in writing on either side.

There was no uniformity in the type of service contracts of senior officers. The management of the group, however, preferred contracts without any fixed period of employment, as their policy was to keep as many officers for as long as possible. Some officers had wished to be engaged in this manner while others preferred contracts which provided for a definite period of employment. The senior officers employed by EMMCO or any other company in the group were liable to be transferred from one company to another within the group. The appellant was employed by EMMCO and was stationed throughout his service at Bukit Besi.

For the efficient working of their mines it was necessary for the group to have a balanced senior staff. They had to keep under their employment mining engineers, operation engineers, control staff and administrative staff. The appellant was the manager of railway and loading equipment. He managed the operation of shifting ore from the wash plant in the mine to the jetty for onward transportation by lighters to ocean liners anchored away from the sea shore.

In late 1966 the life expectancy of the mines was known to be another five to six years; the Bukit Ibam mine was likely to exhaust its iron ore reserves sooner than the Bukit Besi mine. The group, however, remained active in searching and prospecting for new projects. Bukit Ibam eventually finished in 1970 and Rompin Mining Co. itself has gone into liquidation. Hundreds of labourers and technicians were retrenched in 1970. In Bukit Besi, also, production has completely stopped and the mining lesses owned by EMMCO and Trengganu Minerals Ltd. in the Bukit Besi area have been sold away from the group.

By late 1966 it became apparent to everyone concerned that the end of the mines was approaching. There were then no foreseeable new large-scale mining operations within the group. There were few opportunities elsewhere in the iron mining industry in Malaysia, but there was then considerable mining activity in Australia. The result was that there was a tendency on the part of some of the senior "key" officers, whom the management wanted to retain, to resign or to decline re-engagement. The expatriate staff also feared that their appointments might be Malayanised.

As an inducement to those senior officers whom they wished to retain, the management decided to give an assurance that if the Government withheld permission for a non-Malaysian officer to work in Malaysia, or if his services were no more required by the group, the officer concerned would be paid a lump sum equal to one year's salary by way of compensation for loss of expectation of further employment. This assurance was contained in a confidential letter dated 20th December 1966 from the Chairman of EMMCO, addressed to 36 senior officers including the appellant.

The appellant's services were terminated under the provisions of and pursuant to clause 22 under his last service agreement, by a notice dated 12th December 1970 to take effect from 2nd January 1971. The appellant was then about 48 years old and he had worked for the company for 19 years. There was no age limit for the senior officers employed by the company, and if his services had been further required, the appellant would have carried on working up to the age of 55 years or even later, by the usual method of executing further service agreements. The reason stated in the notice of termination of the appellant's service was that due to exhaustion of the company's ore resources the management had reached the decision that the mine must close down. The appellant's monthly salary then was $2,950/-. On that basis and in accordance with the assurance and undertaking given in the confidential letter of 20th December 1966 the appellant was paid a lump sum of $35,400/-.

In respect of the sum of $35,400/- paid to him by EMMCO the appellant was assessed for income tax in the sum of $8,920.80, presumably on the ground that what was paid to him was either a remuneration or a gratuity within the meaning of paragraph 13(1)(a) of the Income Tax Act, 1967, so that it was assessable under section 4(b) of the Act.

The appellant appealed to the Special Commissioners of Income Tax on the grounds that the sum of $35,400/- was awarded to him by his employers as compensation for loss of employment within the meaning of section 13(1)(e) of the Income Tax Act, 1967, so that it qualified for exemption under paragraph 15(1)(b) of Schedule 6 to the Act, and that as he had completed 19 years' service with his employers, the exemption under the said paragraph 15(1)(b) amounted to $38,000/- which was greater than the amount of compensation, so that he was not liable to pay any income tax.

The Special Commissioners rejected those grounds in support of the appeal, and accepted the contention on behalf of the respondent that the sum of $35,400/- calculated at the rate of one year's salary was paid to the appellant in respect of services rendered and was in fact a remuneration or a gratuity within the meaning of section 13(1)(a) of the Act. They accordingly held that the said sum of $35,400/- was assessable to income tax under section 4(b) of the Act without any right to exemption under paragraph 15(1)(b) of Schedule 6 to the Act. They further held that the income tax on the amount received by the appellant as a lump sum by way of gratuity or remuneration should be assessed in accordance with the proviso to section 25(b) of the Act, and ordered the assessment to be amended accordingly.

From the decision of the Special Commissioners an appeal was brought to this court by way of case stated on the requisition of the appellant.

At the hearing of the appeal before me, counsel for the appellant delivered written submissions, a detailed analysis of which, in my opinion, is unnecessary. What is important is the summary of his arguments which is contained in the last two pages of his written submissions. The arguments in support of the appeal as contained in that summary are as follows. On the evidence before the Special Commissioners, it was clear that the appellant had every prospect of continuing in employment, and there was no evidence to suggest anything to the contrary. The employment need not have continued, but the acid test is whether, in the words of Rowlatt J. in *Chibbett* v. *Joseph Robinson & Sons*,[1] it was an employment that was likely to continue. The payment was made in full regard to the prospective loss occasioned by the depletion of iron ore reserves, necessitating the deprivation of appellant's employment. In the circumstances, the payment made to the appellant, if exigible to tax, at all could only be charged under section 13(1)(e) of the Act as compensation for loss of employment.

The argument in the alternative is that, the payment having been made entirely on the volition of the company and not arising out of any legal or contractual obligation but upon the termination of employment, it was not a payment in respect of having and exercising employment and was therefore outside the scope of the charging provisions of the Act. A further argument in the alternative is that, if the undertaking by the company by its letter of 20th December 1966 were to be regarded as an inducement, a payment in pursuance of that undertaking cannot be deemed to be in respect of exercising employment which was in itself sufficiently remunerated, and as such is outside the scope of the Act.

In support of the Special Commissioner's decision, counsel for the respondent contended that the sum paid to the appellant was a remuneration or a gratuity within the meaning of section 13(1)(a) of the Act and therefore assessable under section 4(b) of the Act, that it was not a compensation under section 13(1)(e) of the Act because it was paid in pursuance of an assurance and undertaking that the company had given to the appellant as an inducement for him to stay on in employment and that payment having been made in respect of services over a period of 19 years, it should be treated for tax purposes under section 25(4) of the Act.

Counsel for the respondent went on to argue that normally with the resources of the mines coming to an end, the employees would have opted to go but they stayed on because of the undertaking. He further said that the payment was in the nature of a deferred remuneration so that there was direct relationship of the payment to the office which the appellant held. It was urged that a payment made as an inducement to remain in employment cannot be called compensation for loss of office. In this connection reference was made to the cases of *Hunter* v. *Dewhurst*[2] and *Henry* v. *Foster*.[3] In short, it was argued that payment here was not related to deprivation of office.

In the alternative, it was contended that the payment being a gratuitous payment for past services, it was a gratuity, this being clear from the letter terminating the appellant's services wherein there was reference to his loyal services. The case of *Holloway* v. *Poplar Corporation*[4] was cited in support of this proposition.

In his further and written submissions, counsel for the respondent referred to the case of *Prichard* v. *Arundale*[5] in which Megarry J. said that it is the realities of the payment that matter and not any disguises or labels with which they may be provided. The same thing of course has been said in some earlier cases to which I need not refer. He also referred to some other cases which in my opinion do not call for serious consideration. He finally referred to the case of *Cameron* v. *Prendergast*.[6] That was a case in which the taxpayer who had for a number of years been a director of a company indicated his intention to resign. The other directors asked him not to serve his notice of resignation. Later they offered him £45,000/- for the consideration that he should not serve the notice of resignation. He accepted the money and continued to be a director of the company. The sum of £45,000/- was assessed to tax. The House of Lords held that as the money was paid to the appellant by the company in his capacity as a director of the company and to induce him to continue to hold that office, it came within the charging words of Schedule E. It was submitted that the facts in that case were identical to the facts of this appeal, the only difference between the two cases being that here the appellant received the money at the end of his employment.

The decision of the Privy Council in *Comptroller General of Inland Revenue* v. *T.*[7] (*Knight's* case) was relied on by counsel for both parties to this appeal in support of their respective arguments. Counsel for the appellant contended that *Knight's* case had a direct bearing on this appeal both in law and on the facts. Counsel for the respondent, on the other hand, contended that the facts in *Knight's* case were entirely different from the facts in this case. Although he did not say so in so many words, he probably meant to direct my mind to my judgment in the High Court in *H.* v. *Comptroller-General of Inland Revenue*[8] (*Heywood's* case) in which I sought to distinguish that case from *Knight's* case[7] in which I had delivered judgment in the Federal Court. *Knight's* case[7] had gone to the Privy Council but it had not been decided by the time I gave judgment in *Heywood's* case.[8] My judgment in *Heywood's* case[8] was upheld by the Federal Court but there was a further appeal from the Federal Court to the Privy Council.

Having heard all the arguments in this appeal, and with the judgment of the Privy Council in *Knight's* case having been brought to my notice, I began to entertain doubts as to whether I had decided *Heywood's* case[8] correctly. I therefore decided to reserve judgment in this appeal until after the Privy Council had determined the appeal in *Heywood's* case.

Now that the Privy Council has delivered its judgment in *Heywood's* case (*H.* v. *Comptroller of Inland Revenue*[9] I find no difficulty in deciding the question at issue in this appeal. It is to be observed that the facts in this case are not very different from the facts in *Heywood's* case. In each case the employment was under a series of contracts for a tour of duty of varying but continuous periods. In *Heywood's* case there was a scheme for calculating the payment of compensation right from the beginning. In the present case the scheme for calculating the payment of compensation was introduced rather late, but it was nonetheless a scheme. The letter of 20th December 1966 in this case was nothing more than an expression of the company's intention to pay compensation and called, neither expressly nor by implication, for any acceptance or reaction by the appellant. A mere silence in the face of such an intention cannot be taken as assent to any change in the service agreement.

I do not think there is any merit in the argument that what was paid to the appellant was deferred remuneration. The appellant had at no time indicated any intention to resign. There was no immediate payment made to the appellant as an inducement for him to remain in service. *Cameron* v. *Prendagast*[6] therefore has no relevance to this case.

In delivering the judgment of their Lordships of the Privy Council in *Knight's* case,[7] Lord Wilberforce said at page 74:

> "But it remains the case that in order to be taxable, a gratuity must be paid in respect of employment — many gratuities are so paid as 'tips' and these no doubt are taxable. If the gratuity is not so paid but is paid in respect of the termination of his employment, it is not taxable."

It has been contended on behalf of the respondent that what was paid to the appellant was a gratuity. Assuming that it is to be regarded as a gratuity, can it be said that it was a gratuity paid in respect of employment? I do not think so. On the facts of the case there can be no doubt that it was a gratuity, even if one is to call it by that name, paid in respect of the termination of the appellant's employment.

In *Chibbett* v. *Joseph Robinson & Sons*[1] it was held by Rowlatt J. that "compensation for loss of employment which need not continue, but which was likely to continue, is not an annual profit within the scope of the income tax at all." That decision of Rowlatt J. was approved by the Privy Council in *Knight's* case.[7] In *Heywood's* case[8] their Lordships of the Privy Council said that they could see no reason to dissent from or question the proposition that for a payment to be compensation for loss of employment, there must be a real prospect of future employment. Can it be said in this case that the appellant had no prospect of future employment under his last service agreement with EMMCO which was not limited to any period? I do not think so. It is abundantly clear therefore that the sum of $35,400/- paid to the appellant by his employers was compensation for loss of employment and as such is not liable to income tax by reason of the exemption under paragraph 15(1)(a) of Schedule 6 to the Act.

For the reasons I have stated I would allow the appeal with costs and set aside the order of the Special Commissioners.

Appeal allowed.

Solicitors: *Shearn, Delamore & Co.*